Markets Outlook

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Invest AD
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Abu Dhabi Investment Company

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Investors look to North African bonds in hunt for yield

By Ram Mohan

North African bond yield spreads have tightened notably since December and could narrow further in the coming weeks as investors who are focused on the Middle East hunt for yield in the region's periphery.

Many investors are taking the view that yields in the Gulf Cooperation Council (GCC) cannot grind much tighter, having avoided the emerging market volatility in recent weeks, which was driven by nerves over a slowing Chinese economy and expectations of U.S. Federal Reserve plans to taper its monthly bond purchases. The GCC is seen as a safe haven because of the region's current account surpluses and currency pegs, and the slow pace of primary bond issuance this year has also served to drive up secondary market prices.

Investors with a greater risk appetite have therefore turned their gaze to North Africa.

Egypt, in particular, has seen a sharp rise in market confidence thanks to a sense of greater political stability and improving macro-economic fundamentals, mostly driven by disbursement of assistance from Arabian Gulf countries.

The country, which has been struggling with current account deficit and downward pressure on its currency, received more than US$12 billion in pledged aid from Saudi Arabia, Kuwait and the United Arab Emirates last year and Gulf Arab governments are indicating it is now the turn of the private sector to become more involved.

The aid is helping to address the shortfall in foreign direct investment, which fell to US$ 3 billion in the last financial year, compared to an annual average of around US$ 10 billion in the 2000s. It has allowed Egypt's interim government to unveil two economic stimulus packages in recent months, totaling US$ 9 billion, with spending earmarked for a Suez Canal development corridor and social programmes.

The increased investor confidence can be measured by the tightening of Egypt's credit default swap spreads by 130 basis points this year to around the 470 level. The sovereign U.S. dollar bond that matures in 2020 has seen yield compression of 135 basis points in the last three months to 5.25 percent.

Moroccan bonds have also experienced a rally this year, although for slightly different reasons. The economy, which has been hit hard by the crisis in the Eurozone – an important source of remittances and export revenue – is beginning to improve, albeit slowly. And recent fiscal reform and signs of strengthening external demand are starting to encourage investors.

But the fact that the sovereign is investment-grade, rated BBB- by Fitch and Standard & Poor's, puts the country on the radar screen of many investors who are put off by Egypt's sub-investment grade rating. So although Morocco's CDS spread has hardly budged this year, its sovereign bond maturing in 2022 has seen its yield fall by 55 basis points this year to 4.75 percent.

The moves in North African markets contrast strikingly with Sub-Saharan Africa credit markets. The yield on Ghana's 2023 bond has widened by 100 basis points to 9.40 percent, while the yield on the equivalent Nigerian bond has risen by 15 basis points to 6.00 percent.

At some point, long term investors are already selectively looking at Sub Saharan Africa as a buying opportunity, but in the current risk-off environment, North Africa continues to benefit from a blend of relative value and improving macroeconomic fundamentals.

Ram Mohan is vice president of treasury and capital markets at Invest AD

Equities

GCC

With the first quarter drawing to a close, earnings expectations and announcements, along with liquidity trends, are expected to be the key drivers of market movements in the short term. Investor sentiment remains cautiously optimistic given the strong fundamentals of the GCC economies, especially relative to emerging markets in other regions. A number of GCC companies are showing solid underlying growth, and a burst of new projects and investments announced in the UAE, Qatar, Oman, Saudi Arabia and Kuwait is likely to contribute positively to liquidity conditions and corporate revenues.

The resilience of investor sentiment towards the region has been demonstrated in recent weeks by the relatively muted market response to sensitive geopolitical developments. Tensions between Russia and the European Union over Crimea had a limited impact on regional equity markets, which sustained their momentum, though there was some evidence of investors growing more selective.

Africa

While the overall African market outlook remains positive, the performance of individual markets is likely to be mixed, with Nigeria and Morocco set to remain well supported while Egypt may be poised for a period of consolidation. Though little has changed on the ground in Egypt politically or economically, the market has already priced in a substantial amount of positive news. The focus now is on whether the coming months will live up to investors' expectations, as well as which candidates will emerge for the country's presidency. Some progress has been seen in Egypt's international cooperation, such as a deal with the UAE's Arabtec to build 1 million homes nationwide. Elsewhere in North Africa, Morocco reported record visitor numbers for 2013 and flagged an even higher number this year, indicating the industry has recovered from the turmoil associated with the Arab Spring revolutions. Solid corporate results also continue to support Moroccan equities. In Tunisia, multilateral lenders have announced support for the country's ongoing transition to democracy and economic reforms.Corporate results are expected to bolster market sentiment in Nigeria, especially as more of the country's banks report earnings, but may not be enough to turn the market around given the troubling macroeconomic backdrop. Central bank data recently showed Nigeria's external reserves had declined to a 19-month low, a milestone that is likely to play a role in further central bank efforts to support the naira currency. Despite these worries, many investors are likely to remain mindful that the country's broader growth story remains intact.

Iraq

Politics continue to dominate the market picture in Iraq, particularly the negotiations between the central and Kurdistan regional governments over the 2014 budget. Any breakthrough in that process may serve as a catalyst for investors to reverse the market's recent decline, which has seen the gains made early this year unwound in tepid volumes.

The dispute between the central government and Kurdistan over the direct sale and export of Kurdistan's oil has resulted in the central government withholding the region's budget and has inflicted economic damage on a number of fronts.

The fallout from this stalemate may be contained this year by strong growth in oil production, which has resumed due to expanded capacity at Basra and rising output from the southern fields of Majnoon. The start of production in West Qurna-2, considered the world's second-largest untapped deposit, should boost flows even further.

One potentially positive development is the reported launch of Bismayah New City, the first project of its scope near Baghdad, which involves the construction of more than 100,000 homes and represents the first foray in a drive to tackle the country's housing crisis. Nonetheless, nationwide many much-needed government-backed infrastructure projects have been put on hold until the budget issue is resolved.

Market data as of March 23, 2014

Country/Region	Closing price	MTD	YTD	3M	1Y	3Y
S&P GCC	191.32	1.64%	9.44%	9.55%	34.80%	49.07%
S&P Frontier BMI	108.54	-0.38%	2.00%	3.45%	13.11%	7.55%
S&P Pan Arab	178.38	1.69%	9.82%	9.80%	33.32%	41.92%
MSCI Emerging Markets	944.96	-2.15%	-5.58%	-4.46%	-4.30%	-9.25%
MSCI World Total Return	4,327.66	-1.18%	-0.08%	1.40%	17.79%	33.39%
MSCI EFM Africa Ex S.A.	653.90	0.92%	-2.89%	-1.45%	10.19%	35.12%
Total return in local currency (MSCI)						
MSCI UAE	166.43	2.73%	19.64%	24.80%	88.70%	157.64%
Saudi Arabia	2,481.24	2.60%	9.67%	9.34%	35.77%	62.99%
MSCI Kuwait	2,110.88	4.69%	9.09%	8.78%	15.01%	4.89%
MSCI Qatar	276.36	-3.25%	11.17%	10.17%	33.63%	54.07%
MSCI Oman	2,051.47	-1.65%	2.39%	3.75%	12.28%	3.66%
MSCI Bahrain	391.24	-5.65%	-3.53%	-1.01%	-13.27%	-26.41%
Total return in USD (MSCI)						-
MSCI Egypt	230.84	5.62%	18.14%	18.24%	43.16%	49.36%
MSCI Turkey	411,918.50	2.31%	-7.97%	-10.45%	-34.63%	-23.83%
MSCI Jordan	318.39	4.66%	13.54%	12.17%	0.40%	-5.29%
MSCI Lebanon	0.50	-2.68%	13.17%	12.50%	6.52%	-12.46%
MSCI Morocco	34.80	1.38%	6.67%	3.82%	7.36%	-27.29%
MSCI Botswana	102.42	-5.28%	-5.78%	-7.46%	-4.48%	13.30%
MSCI Ghana	1,317.56	-3.78%	9.40%	8.90%	14.54%	91.04%
MSCI Kenya	19.66	4.69%	3.13%	5.28%	24.90%	108.91%
MSCI Mauritius	35.12	1.35%	2.09%	2.25%	16.83%	19.34%
MSCI Nigeria	4.34	-2.67%	-16.31%	-13.36%	-4.98%	50.89%
MSCI Tunisia	877.77	-2.47%	9.86%	14.01%	2.21%	-0.88%
MSCI South Africa	105.69	-0.90%	-1.98%	-1.14%	2.55%	-0.83%
S&P Zambia	198.78	3.23%	-3.27%	-2.16%	16.17%	36.54%

Source: Bloomberg

Fixed income

Middle East credit markets have been mainly focused on the Federal Reserve meeting at the end of March. However, despite the jitters sparked by indications rate rises may come sooner than expected, the outlook remains robust and broadly positive. The post-meeting selloff in rates and flattening of the sovereign curve had emerging market credit prepared for the worst. Yet, global credit markets took it in stride and moves in US Treasuries were largely ignored by regional credit names, with most bonds ending 5-15 bps tighter on account of underlying moves.

An interesting theme emerging in the region is the slow move away from short-duration bonds as rising interest rates provide for an uncertain carry environment. There has been some selling in these tenors and with the Fed outlook on US economic growth becoming more positive, more investors will be looking to get out of negative carry investments.

Demand for higher-yield names remains strong in the absence of any fresh issuances. High-yield names such as GEMS, Burgan Bank and Dar Al Arkan have seen steady buying and some hit fresh high trading levels last week.

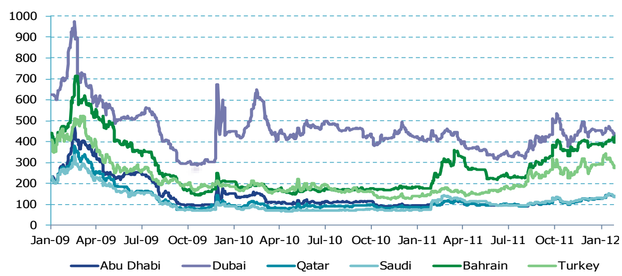
News of Dubai reaching a deal to refinance US$ 20 billion in debt has given fresh impetus to Dubai complex names, especially Emaar bonds, which also benefited from plans to list its mall unit. The market reacted positively to the refinancing as US Treasuries traded at 1.55 percent yield levels compared to the 1 percent refinancing rate, and should help Dubai credits tighten further to other Gulf credits.

In the African fixed-income space, demand for Egypt and Morocco bonds continues, with the benchmark Egypt 2020 Eurobond reaching a fresh high of 103 levels in price terms. The bond has been seeing steady demand since the end of 2013 as well as a yield compression of around 140 bps to trade currently around 5.10 percent yield levels. Sub-Saharan Africa is seeing a combination of two-way flows, with profit booking in names such as Gabon and Angola and fresh buying in Nigeria, Namibia and Senegal as relative value trades are deployed by investors while some take chips off the table.

On the global front, the main focus was on the first Fed meeting under its new chairwoman, which sent some unsettling signals about the central bank's outlook for short-term interest rates. The Fed intends to keep benchmark rates near zero into next year, but signalled that rate increases might come a bit sooner and be a touch more aggressive than expected.

The Fed took several actions at the meeting including pulling back its monthly bond-buying program from US$ 65 billion to US$ 55 billion. The central bank also revised its guidance on the likely path of short-term interest rates, putting less weight on the unemployment rate as a signpost for when rate increases will start. The Fed will now look at a broad range of economic indicators.

Sovereign CDS spreads



Abu Dhabi
Saudi
Dubai
Bahrain
Qatar
Turkey

Source: Bloomberg

GCC CDS spreads

Sov CDS	Level	Wk (bps)	YTD (bps)
Abu Dhabi	53	-1	-2
Dubai	189	-6	-31
Qatar	63	-1	4
Saudi	57	-7	2
FI & Corp CDS			
NBAD	90	2	-1
ADCB	112	6	1
Emirates Bank	213	-2	-4
Samba	104	1	8
TAQA	133	0	0
DP World	160	3	-7

Source: Bloomberg

Market data as of March 23, 2014

Financials – senior	Maturity	Cpn	Bid	Ask	Bid sprd	Ask sprd	S&P	CCY	Type
ADCB	8-Oct-14	4.75%	102.00	102.25	67	22	A	USD	C
ADCB	22-No v-16	4.07%	106.00	106.50	106	88	A	USD	S
ADCB	6-Mar-18	2.50%	100.00	100.75	129	109	A	USD	C
ADCB	3-Jun-23	4.50%	99.50	100.50	201	187	A	USD	C
ADIB	29-Oct-49	6.38%	102.75	103.75	425	398	N.R.	USD	S
BBK	28-Oct-15	4.50%	103.50	104.50	181	119	A-	USD	C
Burgan Bank	29-Sep-20	7.88%	115.25	116.75	312	287	BBB	USD	C
Saudi Fransi	22-M ay-17	2.95%	102.50	103.25	123	99	A	USD	S
COM QAT	11-Apr-17	3.38%	104.00	104.50	113	96	A-	USD	C
DIB	30-M ay-17	4.75%	106.50	107.25	171	148	BBB+	USD	S
Emirates Bank	28-Mar-17	4.63%	106.25	106.75	164	147	A3	USD	C
First Gulf Bank	9-Oct-17	2.86%	102.25	102.75	115	100	A	USD	C
KIPCO	05-Feb-19	4.80%	103.50	104.25	242	225	BBB -	USD	C
NBAD	13-Aug-19	3.00%	100.50	101.00	114	104	A+	USD	C
Qatar Islamic Bank	10-Oct-17	2.50%	100.75	101.25	122	108	A-	USD	S
QNB	14-Feb-18	2.13%	100.0	100.50	126	114	A+	USD	C
Saudi British Bank	12-Nov-15	3.00%	102.75	103.75	78	17	A	USD	C
Tamweel	18-Jan-17	5.15%	106.25	107.25	208	172	BBB +	USD	S

Source: Bloomberg